

Simon Flannery - Morgan Stanley

Thank you.

**Operator**

We'll go next to the site of Brett Feldman with Deutsche Bank, your line is open.

Brett Feldman - Deutsche Bank AG

Yeah, just a two questions, and one just a housekeeping one. I think you had a customer a onetime \$2.2 million benefit in the quarter. I'm just wondering if you'd give us any color as to where that was recorder in terms of what revenue line item was impacted by that, so we can get our run rates right?

**Mark A Peters**

Yeah, so that hit the Enterprise Data [inaudible]

Brett Feldman - Deutsche Bank AG

Great. Okay, and then, you talked about some margin issues during your prepared remarks and there was a little commentary on that in the press release. I think we all understand that early in the year and the first quarter there's always some seasonality, but what I'm having a hard time putting apart is, how do we think about some of the other [inaudible] initiatives that you have going on early in the year? Is most of the margin issue going to be contained in the first quarter, or will this be spread a little bit out over maybe the second and third quarters? Just as a modeling exercise, how do we sort of know when you're coming through that?

**Mark A Peters**

So, we started adding in particular the sales resources in December. And we're going to continue adding, you know, both the direct sales and then the support resources to make them productive. We started that and we're going to continue that throughout the year too. So that's going to add to our – the S part in it, you know SG&A. So it's going to be recurring cost, that particular item.

And then where we see the EBITDA margin coming back is as we start selling with those sales associates, as well as our embedded base growth there, start driving that margin up again. So, we take – so that's from the recurring cost standpoint. That's a recurring item.

Now the other item we mentioned in the first quarter is around \$4 million of increase cost that's coming right in the first quarter because of payroll taxes primarily. And that one goes away throughout the year. So that gradually – that cost gradually goes away throughout the year as everybody hits, you know, whoever hits their taxes in those regards themselves.

So, some of the costs are going to continue, and then some will go away as the year progresses. So, that's why we say that as we get more sales [inaudible] You know, our sales are pretty good. I just want to say that. So, as we grow more sales, converts to more revenue, and build more density, that's where we continue as the year progresses to see some of the, you know, the return of the margins.

Larissa L. Herda - Chairman, CEO and President

And we're moving faster on hiring the sales people than we have previously done. Actually it's kind of in line like you said with the '09, 2010 time frame. Because there's plenty of demand out there. We feel that if we start to bring the sales people on early in the year, by the time they're acclimated,

you know, we will have a number of new product capabilities beyond the Intelligent Network capabilities, by the way, we're also enhancing our managed services capabilities as well. So, we'll have more for them to sell, and I think that, you know, timing is important and that's why we started this process at the end of last year.

**Brett Feldman** - Deutsche Bank AG

Thanks for that color. Actually I just wanted to ask one more question about a comment you made earlier. You said that one of the things you'll be doing this year is looking to expand your network with an existing into adjacent markets. Can you give us an update? What is your geographic coverage right now? I mean, do you have a certain number of markets you're in? Are you looking to add a specific number of markets? I just want to make sure I understand how to interpret that comment.

**Larissa L. Herda** - Chairman, CEO and President

That was kind of more of – it's almost a business as usual type of thing. But we are doing – we always do market expansions in our markets. It depends on how you count them, we're in 75 markets around the country, I'd argue we're probably in a lot more than that because we have tentacles that go out, you know, all over the place. So, we have great opportunities to do that, and so we're going to continue to do that.

**Mark A. Peters** - CFO and EVP

Yes, Brett. We're in 75 markets, and if you look at the map, you know, it covers a great portion of the U.S. And so what we do is we – when we say a [inaudible] market, you know, we might move, or we have moved from Minneapolis into St. Paul, but we leverage all the infrastructure in Minneapolis.

**Larissa L. Herda** - Chairman, CEO and President

Or Spokane to...

**Mark A. Peters** - CFO and EVP

Spokane, you know, Coeur d'Alene

**Larissa L. Herda** - Chairman, CEO and President

Coeur d'Alene, yes.

**Mark A. Peters** - CFO and EVP

So, those kind of things that we do to leverage our embedded infrastructure, but we haven't since 2001 actually gone in and built a brand new market.

**Larissa L. Herda** - Chairman, CEO and President

And we're not expecting to do that. There's so many opportunities for us to leverage with our existing management teams and our existing markets, we can stay busy for many, many, many years. You know, we're in more buildings than any other non-incumbent carrier in the U.S. in terms of fiber, but we still have less than 20,000 buildings. So, there's a lot of opportunity for us to grow.

**Mark A. Peters** - CFO and EVP



And we can reach, you know, any of our customers – virtually any of our customers and location even if we're not in those markets. So we can provide that complete package to our Enterprise customers.

**Brett Feldman** - Deutsche Bank AG

Great. Thanks for taking the questions.

**Larissa L. Herda** - Chairman, CEO and President

Sure.

**Operator**

We'll go next to the site of Colby Synesael from Cowen and Company. Your line is open.

**Colby Synesael – Cowen and Company, LLC**

Okay, thank you. Two questions. Number one; Just looking at your CapEx guidance 360 to 370. If I take the mid-point 365 and apply the 23.4% revenue since you noted to be similar to what you're you sent in 2012, that equates to about 1.56 billion in revenue, which [inaudible] growth in 2012 is just over 6%. I'm curious if that's that type of deceleration in growth rate that you're eluding to when you talk about the business.

And then the second question has to deal with the buybacks. I was a little confused. We're you suggesting that you could cancel the buyback program and potentially put that money towards the convert, or you may increase the amount of money that you're giving back to shareholders and therefore increase the buyback. And they tie in to that would be your NOL. I think your NOL's have obviously been helping you from a tax perspective, but those will most likely run out in the next few years. Could you just remind us how much NOL you have, and when you expect those to potentially run out? Thanks.

**Mark A. Peters** - CFO and EVP

Sure. So, let me get the first one. And I think when you think about our capital intensity, the operative word is "similar". So we have a range of CapEx, and you look at a range of capital intensity, and I think – we're not going to give guidance, and we purposely don't do that.

So a bigger range probably when you're looking at what the revenue growth rate could be. So, we're not giving any guidance on what that might be. So that's...

**Larissa L. Herda** - Chairman, CEO and President

I do think that, you know, it's no secret if you look at our, you know, our revenue over the course of last year, there were some deceleration occurring on a year-over-year basis. And so, that's one of the reason – and you know, I think one of the promising elements is that we actually sold more last year, you know, bookings than the previous year. We did it with fewer resources, fewer sales resources. So for us, it's really a numbers game. You know, if we add the sales resources then we will sell more. And we've obviously gotten more productive and more efficient in how we've been selling. And we're selling to more complex services, they're very sticking, so we've been able to maintain really attractive churn rates as well.

So, I think, you know, when you look at all of those things, you know, we're simply doing what we've done in the past, and it's a numbers game in terms of how many sales people you have, and the

productivity. So, you know, we think we can start to reverse that trend, but obviously it takes a little time for the sales people to come onboard and be ready to sell.

**Mark A. Peters** - CFO and EVP

So then talking about the [inaudible] buyback program and the convert. I didn't mean to imply that we weren't going to return to shareholders. When we look at the convert and how we might address that. In April the first time that we could call the convert, I know that the terms doesn't mean we'll do it in April, but that's an opportunity.

We look at doing it in really the most shareholder-friendly method as we look at it holistically and that's why it kind of compliments our stock buyback program. So, we'll be looking at that kind of holistically in how we want to approach it.

Like I mentioned in our call, you know, we're being opportunistic in how we're approaching it, and now in the context of this [inaudible] we're just going to look at it more holistically, that whole program. But again, to do it in a shareholder friendly way, we believe in stock buyback programs and returning....

**Larissa L. Herda** - Chairman, CEO and President

And we're not decreasing our commitments on that either, so I think that's important to know. We're just – our methods may be – would be different.

**Mark A. Peters** - CFO and EVP

Yes. Because – obviously we can see from the financials we haven't executed a lot buybacks recently.

As far as the NOL, the number is just under \$900 million of the Federal [inaudible] \$100 of the NOL, so clearly, were you thinking that we've been using it, but that's the number.

**Colby Snysesael** - Cowen and Company, LLC

Okay.

**Operator**

And we'll go next to the site of Barry McCarver from Stevens. Your line is open.

**Barry McCarver** - Stevens

Hey, good morning, guys. I guess first off on the – we talked about the sales channel quite a bit, but we didn't really flush out sort of your expectations this year on the indirect side. It certainly sounds like that's remaining a very important channel and maybe something you're going to focus a little bit more on in addition to your direct sales?

**Larissa Herda**

So, yes, you're right. You know, we've had – we have, I think, one of the more disciplined and direct programs out there in the industry. And what was important when we put the program together was that it was an incremental revenue opportunity for us and not essentially stealing from our direct sales force, which is also a very powerful revenue driver for us and what we've seen, and some of our personal experience, what it's like to be in an organization where you have a lot of sales conflicts. So we put together, I think, a very thoughtful program and Indirect Channel really likes it.



They've been very successful and I think because we do have innovative products and I think because we deliver what we say we're going to deliver on and that doesn't always happen with a lot of their other providers, they keep coming to us as a partner because as I've had some CEOs from those organizations tell me, we know that when we give you the business we don't have to worry about it anymore and that's a big deal.

So we're capitalizing on our success and our growing reputation in that area and we will be adding – we have been and we're continuing to add management resources and sales resources to that because, obviously, you have people who manage the channels and so we expect – the nice thing about those is once you get in and you train them, you know, they're kind of like sales on steroids so it's a little bit of a quicker impact to revenue.

If you look at our various different sales growth initiatives, it's – for those of you who followed us for a long time, it should be fairly reminiscent of things we've done in the past. There's never a silver bullet in this business. You have to move a lot of different dials and we know the dials – we've been doing this for a very long time, we know the dials to move.

Last year, honestly, we were hoping to get some more help from the economy so we didn't think initially at the beginning of the year we were going to need more sales resources, but we're share taker and we're pretty good at it and so we decided that we're just going to go and take more share and not wait around for the macroeconomic to help us lift our boat. So that's what we're doing and so it's pretty straightforward. It's not rocket science. We've done it before. And the good news is we've got more products today than we had several years ago when we did it the last time and we think that's pretty exciting. We also have a lot more buildings, a lot more network, you know, a lot more – generally a lot more – and a better vision. I think, you know, as I've been meeting with customers, they love our vision of what – where we're taking the business. It's very exciting to them to think about being able to connect to us and basically, eventually as we refine the connections that we have to each of the data centers and applications in those data centers from just straight transport to, you know, to our consolidation platform, they'll be able to grab those applications when they need them over dedicated services and that's pretty cool because they can do it instantaneously and they don't have to put a service order in and wait 45 days for it. And this is really a very different way of looking at this business than they've ever seen before.

Now, it's going to take us time to get to that point but we're, you know, we've been moving along this continuum for years. You're just kind of learning more about it as we get closer. And so, you know, as we realize that we actually can do these things because, you know, the vision, you know, five years ago seemed like yeah, we'll see. Now it's like, wait and see, or you'll see.

So we're doing these things and so it's pretty exciting for customers. I think the combination of those things, it excites us, it excites our customers and I think it puts us in a unique competitive position because we're not just talking about going in and I'll sell you an ethernet connection cheaper than the guy next door because when do that, someone's just going to come along and be 10% below you and take it away from you the following year. And we don't – we believe in, you know, in creating more value than that. That's a commodity world that is difficult to sustain growth in and we've been pretty good at being able to look at the future. I mean, we did it with ethernet, it took five years before the market actually noticed it, but we were growing our data revenue for years very effectively, selling a service nobody else was selling back in those days and we had to educate the market, it wasn't unusual for us to get in front of a group of 80 customers and ask them, has anybody else besides us coming in and talking to them about ethernet and nobody would raise their hands.

So that's where we are with our consolidation platform and our Intelligent Network and you know, we think it's a pretty cool position to be in and I think our customers do too.



**Barry McCarver** - Stevens

And just one quick question for Mark real quick. As I'm looking at my model and thinking about where we're going to start off on margins or likely to start off on margins in the first quarter carrying that additional sales headcount through the year, is it realistic to think that on a year-over-year basis for 2013, you know, total margins are going to be flat to slightly down with 2012 or am I really kind of missing the ramp in the second half of the year?

**Mark Peters**

Yeah. I guess I'm not going to get – I'm not going to follow on the guidance on the specific margins, other than to say that, you know, we're going to start off the first quarter light for all the reasons we've said, therefore as we're adding the sales and resources as well as that seasonal tax item. And then as – we'll be adding resources throughout the year and then as the year goes on and with our revenue growth and the pace of that is going to impact to a certain degree where the margins go.

So again, that's – we've done it before and we've made these investments and for all the reasons we've been talking about, it's the right thing to do. But then as we drive more sales and drive more revenue growth, you know, we expect – you know, we're going to get those margins back to where we are and expanding.

**Barry McCarver** - Stevens

All right, fair enough. And then just this last question if I can. Still a really good position as far as your balance sheet. When I think about your growth initiatives to look at new markets and I think the third one was to look at new technologies, you know would that include the possibility of maybe looking at acquisitions to bring into some new fiber or new products and services?

**Larissa Herda**

Well, we're always – we always look at potential acquisitions. We remain opportunistic in that regard. As you can tell from our history, we're not really acquisition hungry. For us, it's a – it's a choice between making the investment in our business and our innovation and keeping our people focused on that or making an acquisition of something we have to fix and probably pay a lot of money for. So we have opted to go in the direction of organic growth and innovation because, quite frankly, we have a lot of assets out there that we, you know, are leveraging. You know, with that said, we do buy fiber literally almost every week because there's fiber out there. We do buy versus builds as far as our decision making is concerned, if it's more economic for us to buy some fiber from a provider that's selling it than that's what we'll do. We're fairly agnostic in that regard and if not, we'll build it ourselves.

But they're generally adjacent to our existing markets so that we can leverage our leadership in those markets and our – and that has proven to be very effective for us.

**Barry McCarver** - Stevens

Great. That's good info. Thanks for taking my questions.

**Larissa Herda**

Sure thing.

**Operator**



We'll go next to the site of Frank Louthan with Raymond James. Your line is open.

**Frank G. Louthan** - Raymond James & Associates, Inc.

Great. Thank you. Can you talk about selling into existing buildings and how that fits into the plan next year? And then, I apologize if I missed this, but if you could let us know what happened with sort of the building audit that resulted in some buildings you found that it seemed like you could pick up? And then, what's sort of the longest timeframe as you've made these sort of investments in the sales force before and they play out over time, you know, what's sort of the longest timeframe you think it takes from this kind of investment before we start to see that in the numbers? Is it more of a 24 – it is a 12 to, you know, out in 24 months, or you know, possibly 12 to 18? Can you give us a timeframe? Thanks.

**Larissa Herda**

Yes, so you know, we always sell in our existing buildings and you know, about a year and half or two years ago we revitalized the organization to do that and they've been doing a good job and we, you know, have seen nice flows, steady progression more on net sales. And in fact, you know, that sometimes impacts some of our costs because on the sales side, commissions are higher, by the way, when they sell all net. So that's a good thing because ultimately that results in better margins for the business in the long run.

So that continues. You know, we've been adding a lot of buildings. We have, you know, that's an ongoing – we're very good at it. I think we're one of the best in terms of adding buildings to the network, so you'll continue to see that. Mark will talk a little bit about the building counts, but in terms of sales people, you know, generally when you bring a salesperson on board, we have sales people that are selling within 90 to 120 days, so – and then you have other sales people that take closer to a year to get up to quota and some take longer than that. So it really depends on who they are. I would say that our indirect channel will sell faster just because they've already got the customer relationships. They're already, you know, well trained, you know, it doesn't take long to train them. And it really differs by segment if you're – if we're hiring, for instance, a national enterprise sales person, it takes a while because they're generally opening up new big customer accounts and those accounts may take a long time to open up but they're always the gift that keeps giving and that's what most of the existing sales people in the national accounts group are busy doing, they're busy expanding their relationships that they already have and so that's why we really need to have more of them because we need more of them opening up more new accounts.

So it really varies, Frank. We'll see some, I think in a positive impact from it in the second half of the year and then we should see some good momentum, especially going into 2014.

**Mark Peters**

Yeah, and the building addition adjustments for this, the increase of 532 buildings on our network, we're continually going through with our system and improving our system's efficiencies and automation and going through that process, we identified these buildings that were connected and we hadn't captured in our system. So that's what happened, we pulled them in this quarter and reported them out and called them out so you could see them.

**Larissa Herda**

And it's just one of those thing, Frank, for instance, I'll give you an example. If you build fiber to a business park where you have four buildings connected but you have one point of presence in that business park, you know, sometimes people will count it as one building and in reality, it's four. So you know, as you go through in time, you realize, oh, well, we're in four buildings, we have

distribution in four buildings, we just have one POP serving all those buildings. So we've worked really hard at part of the automation process and the database, this great program that we have in place now to make sure that, you know, those numbers are counted correctly. So that was really a cleaning-up process that's been going on for a few years now.

**Frank G. Louthan** - Raymond James & Associates, Inc.

Okay, so on the sales and existing buildings, can you give us an idea what was sort of the incremental number of customers, you know, per – on that building this year versus last year? How's that average track?

**Larissa Herda**

We don't take a look at it that way on a holistic basis on each and we've never provided that information publically. We're more interested in revenue per building and what we do is we – we compensate our local general managers, there's an element of their compensation that's based on increasing penetration in their buildings in their market and so – and you know, every year they, you know, that's a metric that they're interested in watching. So that's more how we do it. And every year we're seeing an increase in that penetration of those buildings. Did you want to add anything to that, John?

**John Blount** - Chief Operating Officer

We do track and measure our returns in each of our buildings, in each of our markets, in each of our regions and that cascades up, like Larissa said, into their goals. So it's something we manage, really, on a weekly basis.

**Larissa Herda**

Yes, it's more about returns than it is about individual customers.

**Frank G. Louthan** - Raymond James & Associates, Inc.

Okay. Thank you.

**Larissa Herda**

Sure.

**Operator**

We'll go next to the site of Michael Rollins with Citi Investment. Your line is open.

**Michael Rollins** - Citigroup Inc

Thanks, just following up on the sales comments that you've made, you know, recognize that by adding people you increase the ability to sell in terms of dollars and bookings and so forth. Can you talk a little bit more about the productivity on a per-person basis? Are we just seeing that the sales force that you have is reaching – ignore the major additions you had during the fourth quarter, but just in general, that they might be hitting their full capacity or is there a meaningful opportunity with the new products by focusing on the existing buildings to ramp that productivity that they have today meaningfully higher? Thanks.

**Larissa Herda**



So without giving you specifics since we generally don't provide those specifics, so I made a comment earlier that if you look at what our sales were last year, they were greater than the previous year. Good news. And we did it with fewer sales people which would argue that our productivity is greater. But the reality it is that a lot of your productivity comes from your top sales force and so we do measure how much of our, you know, where the – how far down the stack our sales people actually are producing and they're producing more – more of them are producing more, which is good news. You want to get them all producing something, right, but you want to get more people producing more. You know, this year for our Summit of Leaders event, we have more winners going this year than we did the previous year, which tells us that you've got more people who are – and it's a fairly high hurdle to get there. You have more people who are producing more, so that's good. So you want to get the rest of them to produce too, that's always the art rather than the science of getting a sales force to be productive.

I think your comment is right on target in terms of new products. I don't think our sales force is at full capacity at all. I think our sales – our current sales force could continue to product more but as far as we're concerned, they just can't do it fast enough for us right now because we should be growing faster and we can be growing faster with more sales people and that's why we're putting more in there. So it's just a matter of, you know, it's just a matter of fact.

I think the new products will obviously always energize, you know, especially in our more mature markets, they always get energized with new products. But we put out products all throughout the year but some of these more exciting glitzy products are obviously something more for the sales people to talk about and give them really a different position with their customers so that they're really in a more strategic discussion with their customers than just in there throwing in bids for capacity. And that, that really bodes well for the future, I think, as well. And that's another reason why, by the way, you know, these new products is another reason why we have to make sure that the people we're bringing into the company have some additional different skills as well and have some more IT-centric skills. We've been finding as we hire those types of people they've been very effective so we're capitalizing on that knowledge and continuing to do that.

So I hope that answers your question, Michael.

**Michael Rollins** - Citigroup Inc

That does. Thanks very much.

**Operator**

And we'll take our next question from Timothy Horan from Oppenheimer. You line is open, go ahead.

**Timothy K. Horan** - Oppenheimer & Co. Inc.

Thanks, guys. Mark, did you say how much you're going to be adding to the headcount? Maybe I missed that.

**Mark Peters**

We put that from year end, we're going to probably approach for the direct sales force probably increase it by close to 10%.

**Larissa Herda**

An additional 10% over the 6% that we increased it last year.

Timothy K. Horan - Oppenheimer & Co. Inc.

It doesn't seem like, you know, a real lot, so you might add like 100, 150 people to the total company?

**Larissa Herda**

That may not seem like a lot to you, but that's a lot to us. You're right, it's not like – it's not like any one city is going to get a ton. I mean, when you have 75 markets, you know, not all of them are going to be getting people. Obviously, we've got National Enterprise, we've got Federal, we've got Indirect Resources going on. We also have some, you know, support resources going in as well, right, to support all these people so it's not quite 150, you'd have to up that a little bit. But you know, different markets will be getting resources, so it's not like they will be tough to absorb, but it's hard to find good qualified people so we've got, you know, we've got a full-court press in doing that.

John Blount - Chief Operating Officer

The other thing I'd add to that is that we hire very specifically. We hire into specific opportunities so as you look across, you know, we go and we map where's the opportunity in our markets, you know, what verticals are expanding. And so it's a very – it's a pinpoint attack that we go where we get a specific skill to map to a specific opportunity. Our philosophy has never been just to have hundreds and hundreds of more sales people to see how many of them can stick, you know, we're really kind of going after – when we hire, we hire for a specific module and a specific opportunity.

**Larissa Herda**

So it's a very thoughtful approach.

Timothy K. Horan - Oppenheimer & Co. Inc.

Well, I guess what I was saying, and just a quick follow up, but Mark, you haven't – I guess in the last five or six years, EBITDA has grown faster than revenue fairly consistently. I mean, could you envision that you would spend enough so that the EBITDA would grow less than revenue this year? Is that the kind of magnitude we're talking about?

**Mark Peters**

Yeah, you know, it's all a function of, you know, what ultimately happens at the top of the line. So if we have these sales, sales resources, then it will be product managers, the other will be technology people as well. So as we bring the resources in and they'll be – the margins will then be a function of the timing of, you know, and the degree of the growth rate.

Timothy K. Horan - Oppenheimer & Co. Inc.

Got you. But I mean, your sales have been fairly steady the last couple of years. I think they slightly decelerated but you're in the 7% range here now for a while. I mean, are you worried that this, you know, drops materially down to a 3%, it just seems hard for that to happen.

**Larissa Herda**

So on sales, don't mix the word sales with revenue, right.

Timothy K. Horan - Oppenheimer & Co. Inc.

Sorry, yeah.



**Larissa Herda**

So you know, revenue has been – you know, sales last year was lower for the full year on a percentage basis. Sales growth was lower, which is why we saw deceleration over the course of the year, which is why we are, you know, we're adding more people. So I think that's just an important point to remember.

Timothy K. Horan - Oppenheimer & Co. Inc.

Yep. And Larissa, just on consolation, what's the underlying technology that is enabling this product to happen?

**Larissa Herda**

Well, you know, I'm the wrong person to ask on specifics of technology, but we do have Mike here, but I'll start off by saying that we're leveraging all of our current capabilities and we're developing our own internal capability, you know, from an IT development standpoint. And our ability to have – put a platform out there that's, you know, we talked about this before in the past, the integrated platform, the one network platform where, you know, like Dynamic capacity, I mean, what company do you know can have – give a customer a 10-meg circuit or a 20-meg circuit from Denver to San Francisco and allow that customer to increase the capacity within 12 seconds by three times? Well, the reason why we can do those is we've put this very extensive infrastructure, it's a function of our data, very clean data that we have and it's a function of really integrated all the acquisitions that we've made into this one platform concept. And so what the team is going is that's the leverage point, right. And so you develop fairly complex processes, extremely complex in fact, the ability to be able to do the consolation platform.

Mike Rouleau - SVP of Business Development Strategy

I was just going to follow on to Larissa's point. You know, having consistent network elements with an integrated back office and our secret sauce, frankly, you know, with the ability to reach into each one of those network elements and allow us to control and deliver the types of capabilities like Dynamic Capacity that Larissa mentioned.

So it's really reaching into those network elements to deliver that predictable network experience for the customer, where they want to connect.

**Larissa Herda**

So we just – generally, when we do things, you know, we like to use as many things off the shelf as we can, but then we do our own development for differentiation and strategic advantage so there's a lot of proprietary work involved and we generally don't give out the names of the technology we're using because why should we tell our competitors what we're doing.

Timothy K. Horan - Oppenheimer & Co. Inc.

Sure. Thanks a lot.

**Operator**

We can go next to the site of Donna Jaegers with D.A. Davidson. Your line is open.

Donna Jaegers - D.A. Davidson & Co.



Hi. Inspiring call so far. One quick question on the E-Access wholesale product. Has that been launched in the market now? Can you talk a little bit about what sort of reception you've gotten and any sort of update on the FCC looking at special access?

**Larissa Herda**

Sure. So E-Access launched in the second half of last year in the fourth quarter and just to remind everybody, that's the one-to-many products that allows customers to connect to us for ethernet services in one location and then we take them across the United States. What's been happening is primarily entrance facilities have been put in place with quite a few carriers and now they're starting to, you know, as they sell new services, they're starting to add the end links to those so we should expect to see some momentum as the year progresses and that takes time, obviously because just putting the entrances – this is new for a lot of carriers, so you know, you've got to work on all the technical intricacies of getting the facilities in place. But we're very pleased, and by the way, that is one of the reasons why we're adding more sales people, which I can't remember the last time we added sales numbers in the wholesale group. It's been many years. But we see a lot of demand for that. I was actually at a conference recently and I happened to be walking next to the president of a large global telecom company and he, you know, they're a customer of ours and in a kind of a small way and he personally was not aware of these capabilities that we had and he was pretty excited about it and couldn't understand why they weren't using us more and we've been in contact since that conference and I think the teams have renewed interest on their side because he definitely could see, you know, what this meant for his business. So you know, we've been seeing a lot of excitement coming from the international carriers, but these things happen over time, you know, as you know, Donna, there are no hockey sticks in this businesses. We have to be patient but eventually the results show up.

Then the...

**Donna Jaegers** - D.A. Davidson & Co

On the FCC special access, is that a gating factor, how fast the wholesale carriers can use you guys?

**Larissa Herda**

It has no impact on that. You know, what we just did, you know, on special access, has more to do with dealing with something we've talked about before that we unaffectionately call the heroine drip, that the incumbent carriers require both their end user customers and carriers to make ever-increasing commitments to old technology over the years while the world is moving to new technology and it keeps companies from being able to buy services from other competitive carriers. So there's a lot of words for that, but that's just an on-going process that we have going on and we just made a filing this past week with a coalition of other carriers and they were comments to the FCC's further notice to propose rulemaking as part of the ongoing review of special access. So you know, I think the team did a great job putting in their explanations and provide some really compelling things. Obviously, nothing moves really quickly in the regulatory environment but we're asking for some relief, really, really asking for it quickly from that because obviously, we all want to be able to move to new technology. We also want to be able to sell to whoever wants to buy from us without them feeling that they constantly have to submit to the heroine drip for services that they really don't want or need.

So that's all that's about, but it has no – you know, other than the future ability to be able to buy services at reasonable rates and at reasonable service levels, we continue with our strategy because, remember, the vast majority of what we sell is on our fiber network, 100% on our fiber network, but unfortunately, for every carrier in the United States, including the incumbents, none of



us have complete ambiguity and we have to buy services from other carriers to be able to complete services for our customers who want us to do everything for them, not just what we can do on that.

Donna Jaegers - D.A. Davidson & Co

Okay, thanks, Larissa.

**Larissa Herda**

It looks like we have – I know we've run over and I apologize for that so we're going to take one more call here. I mean, one more question.

**Operator**

And we'll go to that question from the site of – the line of Thomas Seitz from Jefferies. Your line is open.

Thomas O. Seitz - Jefferies & Company, Inc.

Yes, thanks for getting me in. When you look at constellation, as you roll it out, do you think it's going to be used primarily to open doors to new accounts as a point of differentiation or are you going to use it – are you going to start by targeting current customers? I understand probably both over the long term, but with the launch, do you think one presents more opportunity than the other?

**Larissa Herda**

So you know, I'm not sure how to answer that. Current customers have a tendency to buy things quicker because they already know who you are. But I think that we're opening up a brand new opportunity here for customers. You know, there's a number of – there's one really big application provider, for instance, who's been working on dedicated services to enterprise businesses and trying to expand their relationships and one of the frustrations that they've had is this Telco, got to put it in order and wait 45 days, got to wait for this, got to wait for that. And so, and so when we look at our business, we're already connected into all these locations, so for us to create machine to machine interfaces or API interfaces with these organizations so that you know, we can present our – you know, our service can be presented as part of their portal to customers and they can just click and go, yeah, I want that service and if it's in one of our buildings, you know, they can have it maybe in a day, maybe if it's already connected to that customer in the building they could have it immediately, right. But the nice thing for the customer is we're already connected into the application provider and if we have this machine to machine connection, they can actually grab the application on a dedicated service instantaneously. So that is a whole new world. This is a whole new world for customers and a whole new world for data centers and a whole new world for application providers. So I think it's different, it looks a little different from each of their perspectives.

But now, for us, what we like about it is there's no people in the process, right. I mean, you don't have any people in the order process so this is a very interesting scale opportunity for us to be able to turn services up in a very rapid way, utilizing this infrastructure that we already have and so it's a fairly innovative – it's an extremely innovative way to connect to customers. Did either of you want to say anything?

**Unidentified Company Representative**

No, I think you hit it; speed, flexibility, choice, ease of use. That's going to be appealing to existing as well as new.

**Larissa Herda**



So while Dynamic Capacity opens more doors and closes more deals, this was a bit more than that because this one – this one changes the fact of how telecommunication providers interact with their enterprise customers and interact within the data center, you know, environment. Data centers don't stand as an island and today, you've seen some providers throw dark fiber in there or a fixed capacity in there, and yeah, big deal, it becomes a commodity after a while. And – but what we're doing is saying, well, customer, you're already in our building, we're already in your space, we're already in this data center, that data center, that data center, and oh, by the way, we can – that data center – we're connected to all these applications that you can connect to. This is easy for you. You don't have to worry about the whole Telco model and you can connect up to that. And the future of this is quite exciting when we think about it. And again, it will take time, but it's fairly – it's a very radical way of thinking. I can't imagine other carriers being able to do without maybe having to build a whole network on top of what they've got. And fortunately, we built this very integrated network, which allows us to do it with our existing investment and I think that's one of the keys is continuing to leverage our existing investment. These are primarily, today, they will be on net services, right, you know, someday we'll connect to off-net services as well. But nice high-margin business without a lot of people in the middle of the process. We like that model.

Thomas O. Seitz - Jefferies & Company, Inc.

I guess my follow up would be, you know, if it is in the data centers where you're already connected, if it's in to current customers, that is, you know potentially the initial sales avenue, can you help us size it? I mean, is this – do you think this is a big enough opportunity that you could see the margin impact you sort of alluded to a couple minutes ago, you know, even in 2013?

**Larissa Herda**

No. You won't see the margin impact on this in 2013. Things don't move quite that quickly in this business. The key here and the power of this is linking the application and the network together, right, and that's something different than what others have ever done. So I think this is a vision that we wanted to make sure you all knew where we were going. You're going to start to see elements of that vision start to take shape over time just like the Intelligent Network. You know, we started off with the Intelligent Network, we figured that was enough to get everybody to absorb last year, and I think everybody's got it and I think, you know, we're doing it, people understand it. I think our investors are starting to understand and I think, over time, you'll start to see how that will impact our results over time. The constellation platform is really just the next level of that in our thought process and you know, and I anticipate there will be more that we'll share with you someday, but for now, I think this is enough. And I think we have – I think it's the right vision. I think it's the – I think it's what customers tell us they want. A lot of this came from customer roundtables that we've had where customers would just say, oh my gosh, this is – it's just so hard to deal in the Telco world, and it really is. I mean, Telco companies have never been well known for providing excellent service, right. We do a pretty good job, but we really wanted to change and really – what really inspired us was, you know, our own iPhones and our own iPads and how easy it was for us to just click and connect to over the internet and we thought, well, if we have all this fiber and we're already connected to all these locations, why can't we do that for customers of dedicated services because they're not going to buy a lot of those applications over the internet, it's just not secure enough.

So we can do it differently because we have a different set of assets and we deployed them differently than others have and we've integrated them differently than others have and I think that's put us in a very unique position to innovate differently than others can.

Thomas O. Seitz - Jefferies & Company, Inc.

All right, great. Thank you very much for the color.



**Larissa Herda**

All right, thanks a lot. And sorry for going over, but hopefully that was helpful to everybody. Thank you all for supporting tw telecom.

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# EDITED TRANSCRIPT

TWTC - tw telecom inc. at UBS Global Media and Communications  
Conference

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DECEMBER 04, 2012 / 2:00PM, TWTC - tw telecom inc. at UBS Global Media and Communications Conference

## CORPORATE PARTICIPANTS

**Mike Rouleau** *tw telecom inc. - SVP, Business Development and Strategy*

**Mark Peters** *tw telecom inc. - EVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**John Hodulik** *UBS - Analyst*

## PRESENTATION

**John Hodulik** - *UBS - Analyst*

Okay. Thank you all for joining us. I'm John Hodulik, the telecom and cable analyst here at UBS.

I'm very pleased to announce our next speakers from tw telecom. We have Mark Peters, the Executive Vice President and CFO, and Mike Rouleau, the Senior Vice President of Business Development and Strategy. The two are going to provide about a 30-minute presentation and then we can do Q&A after that. So with that, let me turn things over to Mike.

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**Mike Rouleau** - *tw telecom inc. - SVP, Business Development and Strategy*

Good morning. Thank you very much.

Before we start, I'd also like to draw your attention to our Safe Harbor statement here on slide two. Information in this webcast contains statements about expected future plans and expectations that are forward-looking and are subject to risks and uncertainties. A discussion of factors that may cause our results to differ materially from our expectations is included on slide two here.

So, with that, let me start with a little bit about our Company and what we've been doing. We have been very, I guess, consistent, if you think about how we have grown our revenue, 32 consecutive quarters of sequential growth, and a lot of that is driven by our data and IP services, which grew 14%, almost 15% year over year.

We have a very strong modified EBITDA margin and positive levered free cash flow for the past 21 consecutive quarters and a growing ROIC, which Mark will talk a little bit further about.

Additionally, we have, really, some industry-leading network capabilities that I'm going to spend a few minutes talking about, and, really, it's focused around what we think about as one network and one platform of capabilities.

If you're not familiar with us, tw telecom is a competitive services provider across the United States and we operate in 75 markets around the US, those dots on the map, if you will. Connecting those dots on the map, are -- is a national IP and MPLS backbone, and the dots are really where we spend the vast majority of our time.

Those represent a big fiber network in a local market that extends all the way out to end-user buildings. So, we have about 17,000 buildings connected with our fiber network directly, which is a pretty significant number for the competitive services market. We're the largest competitive service provider with buildings connected to the network.

And we serve across the United States, with our capabilities, including things like IP services, MPLS capabilities. Ethernet is a pretty strong piece of our business, as well. And so with that, we also, then, can extend internationally through partners to get our customers, really, where they need to go.





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So, we focus on the enterprise business customer that needs reach, domestically and internationally, but focus more on that fiber infrastructure that we can serve them out to their end-user buildings.

A couple of things really make us different. First, we have focused on that fiber footprint, so we have capabilities that we can build fiber infrastructure for customers as they need it, separate from the incumbents, so we can build it into a separate right-of-way, we can build diversity for their disaster recovery/business continuity plan. We have this national backbone that we can extend our capabilities across.

We've built one platform of operating infrastructure, so we have taken a focus around our business to be consistent in the way we do business with our customers nationally so we can give them one set of product capabilities, an integrated back office, a common approach to customer care, and that makes us pretty unique, actually. So, when we think about how customers are working with other communications providers, they don't get that same consistency of experience, that same common platform strategy.

And we have a proven business model that we've been operating now for a number of years with strong local market teams that are backed up by our national operations center and national support. So, that makes us very different from others, as we look at how customers want to do business.

Let me shift gears for a second and talk a little bit about where we're going and taking our customers, as we grow the business. The customers that we work with, the medium and large enterprise customers, are being challenged with a new operating model.

Back in the day -- and that might be today for some customers -- they had their arms around everything. They used to own their own local area networks. They owned their own data centers. They owned their wide area networks. They owned their own applications environment. When their users hit the enter button on an application, that IT professional knew how that application was going to perform.

And now today, they are being challenged with a new operating model. You think about the cloud and some of those applications that these customers are being tasked with trying to manage and get their arms around, and they don't have a good strategy for integrating those capabilities and doing it in a predictable, secure, scalable way.

And so, the challenge that the IT professional that we work with faces is, how do I take that current operating environment, that predictability of the application and the infrastructure, and integrate some of these best-of-breed capabilities where they can go out and get certain applications, certain capabilities in a better way to deliver their applications to their users.

We believe that Ethernet is one of those platforms that the cloud and the new IT architecture is going to take advantage of in a significant way, and we've been a leader in Ethernet services pretty much since the industry started with that capability.

Today, we have a leading portfolio of products and services with Ethernet that we can extend to all of our customer locations on our network, to about 350 third-party data centers that we have connected with that infrastructure, and even extend our reach out into the markets that we're in and give customers the ability to have Ethernet services end-to-end, to deliver that secure and scalable and predictable network experience that the IT enterprise professionals are looking for.

We continue to innovate around Ethernet services. So, we recently launched a service we refer to as one-to-many Ethernet access. It gives customers that are in a data center or another carrier or an international carrier the ability to connect to us in one location and we'll take them across our backbone to our buildings, to the footprint that we have across the United States, and give them an extended reach capability with Ethernet.

Today, most others require that you connect on a market-by-market basis. We're changing the game a little bit for our customers and giving them the ability to connect one time and leverage our capabilities and our national footprint to give them access with Ethernet across the United States, a very different, very unique service.



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When we think about where this is going and the ability to give customers the options to scale their infrastructure, to build out their IT networks with capabilities, we refer to that as an intelligent network approach. It's not just about big, dumb pipes, it's about giving customers more intelligence from the network so that they can manage their applications environment, so that they can deliver better services to their users.

We think there's three key components here that are important, as we think about the intelligent network. First, you have to have visibility about what's going on in the network so that you can make appropriate applications decisions and how you're going to run those applications.

Second, you need more control over your capabilities. You need to have the ability to scale your bandwidth as you need to. Customers are faced with a challenge these days where they don't know what's coming this week or this month or this quarter, and they need to be able to build a flexible infrastructure that allows them to scale their capacity as they need for as long as they need.

And lastly, the network needs to be aware of the applications moving across the network so that you have, really, the ability to control resource to serve that applications environment.

And, as you think about where customers are placing their applications, it might be between their own data centers or to their corporate headquarters or regional offices, but if it incorporates something in the cloud, those customers don't necessarily have the ability to put infrastructure out or to collect information from that cloud destination. And so that's why the network needs to have that sort of capability.

We've been working on our intelligent network approach for our customers and it really consists of three service sets of features that sit on top of our Ethernet service and our MPLS service.

First -- enhanced management, which we rolled out on a ubiquitous basis earlier this year across our MPLS IP VPN service and our Ethernet services, gives customers the ability to see what's going on in the network in real time in a segmented, granular way. So, when you think about how customers look at network management today, they typically look at the overall, the aggregate of the service or the circuit.

What we've done is given our customers the ability to view each segment of the service and see critical information of things like packet loss, latency, jitter, bandwidth utilization, class of service utilization, but to see it in the metro, to see it differently in the long haul, to see it, then, in the remote end.

So, those three distinct views gives customers to do fault isolation and trouble management that much faster and so that they can manage their applications environment and manage the applications moving across the network to serve their customers' needs.

The second phase, which we launched in August of this year, is dynamic capacity. This is the holy grail for our business. We have been talking about bandwidth-on-demand strategies for a long time, and here's where we have leveraged our expertise and leadership in Ethernet to give customers the ability to scale their bandwidth, to double or triple their capacity in real time and use that for as long as they need and pay for what they use.

So, with dynamic capacity, having that broad footprint of Ethernet capabilities, the large number of ports that we have in service -- by most industry analysts, we're the third largest provider of Ethernet in the United States only behind the two largest incumbents -- and give them the capability to scale their bandwidth as they need is pretty powerful and impactful to the enterprise customer.

The third piece is an applications-aware network strategy, which we are working on. And that is where we are focused on giving customers the ability to have more control over network resources based on the applications demands that they have in place.

So, when we look at what customers are doing with their networks, sometimes they want to be able to have flexibility around the network so that they can scale things up to support a critical business application, maybe turn down or constrain certain traffic, things like YouTube or iTunes that may not be business-critical, they may want to put into a constrained effort, a constrained queue, and so it gives them the ability -- the customer will have the ability to scale up their capacity resources as they need for critical applications. Okay?





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Just stepping back a little bit to talk about dynamic capacity, again, our bandwidth-on-demand strategy, again, this is a very unique set of capabilities that we've given our customers, and they have today the ability to go into our portals and they can increase their capacity in real time a couple of different ways.

First, they can go in and, on an ad hoc basis, turn up the capacity as they need it, so they can double or triple their capacity. When they do that and select, maybe, a doubling of capacity, the portal then provides them how much that's going to cost them on a per megabit-hour basis. So, a customer can make a conscious decision about what it's going to cost them, how they're going to manage the business environment.

We also give the customer the ability to name the event. So, if there's somebody in their organization that is causing the need for increased capacity, they can allocate that bill at the end of the month, which is very unique.

And so, when we hit the accept button and the customer says, yes, I want to double my capacity, I agree to the pricing, within 15 seconds we will provision that capacity for that customer and give them the ability, then, use that bandwidth as they need, and, combined with our enhanced management capabilities, customers can see how they use the capacity. They can make a decision whether they need to increase their capacity on a sustained rate.

So, this becomes a sales opportunity for our sales people that will, then, work with the customer, consult with them, identify their needs, understand where they're going with the business and they can make a decision about how to manage their applications environment.

We also have the ability for a customer to schedule an event. So, a customer, let's say, is doing a data backup that starts at midnight on Saturday and goes through 6 a.m. on Sunday morning. We'll give them the ability to program that, to set that up from their desk on a Wednesday afternoon. And so it happens automatically. So, the customer can turn up the capacity, turn it back down, manage it for what they need, and they can manage their operating environment.

So, at the end of the day, what we're trying to give our customers is that same experience that they have today where they have their arms around everything, they have their own data centers, their own applications environment. They can now reach into the cloud to go get a best-of-breed solution, and when their users hit the enter button, they know how that application is going to perform.

We want to give them that secure, scalable, predictable network experience that they can't get anywhere else, that we can give them the ability to scale their capacity and have control over their network resources as they need.

And with that, I will turn it over to Mark Peters.

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**Mark Peters - tw telecom inc. - EVP and CFO**

Thanks, Mike. Hello, everyone. So, as Mike pointed out, we've had 32 consecutive quarters of top-line revenue growth. So, the consistency really is our story. So, think about that, eight years, every quarter we've grown the top line. We've also delivered that strong 36% EBITDA margin.

And -- but when we look at our business, it's one of balance. It's balanced -- the revenue growth is balanced with the EBITDA generation and balanced with the cash flow. And so, while over those eight years the revenue growth rate from quarter to quarter isn't always the same, when I show you some charts in a minute, it's going to almost look like a straight line, even though when you look at it quarter to quarter, you can get some of those from a growth rate perspective.

To generate a 36% EBITDA margin, it's one of the strongest EBITDA margins out there for a company that's a full-service provider of competitive services, telecom services, the networking services that Mike's talking about. So, pretty incredible to deliver those consistent top-line growth rates with those EBITDA margins and the growing cash flow generation, EBITDA minus CapEx.

We do that at the same time while we continue to invest for differentiation and innovation. We're not the biggest guy out there, so we have to compete on service quality, ease of deliver, speed of delivery, the overall customer experience with our customer.



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That's really important. If you've ever bought services from a telecom company for an enterprise, much less residential, but for an enterprise it's difficult. We're trying to change that whole dialogue with the customer, and we have been changing the dialogue with the customer.

So, when they buy services from us and they don't worry just about the physical connection, it's how that whole network comes together for them, it's easy, it's there, it's there when they need it, and it's flexible for their changing demand.

And so along the way, as we continue to grow our revenue and continue to expand our margin, we've been investing in that whole platform that Mike talked about, that one network, that one infrastructure, that one group of systems.

When you look at our growth rate since the end of 2006, which was our last acquisition, it's all been organic growth, which means that everything's integrated. We don't have a bunch of acquisitions that haven't been integrated. This is all organic growth for us, so it's a very clean, scalable, efficient operation, which is why we've been able to deliver that differentiated experience and that strong EBITDA margin.

So, here's some-- I'm going to take you to two different slides on two different cuts of our revenue trend lines. So, this one breaks it down by kind of broad product or service categories.

So, the real growth engine is the data and Internet category. As Mike pointed out, we have -- we're ranked, I think, number three as far as the number of data or Ethernet ports nationwide, behind companies that are multiples larger than us as far as size and scope.

It really talked to how we've been delivering a differentiated service, and that's what's really driving our growth, that data, that Internet/Ethernet connectivity that we've been delivering. And you see the 3-year CAGR is at 17% from that category. And that's about 51% of our total revenue.

So, 51% of our revenue had a 17% CAGR. So, a very attractive -- the math works. Once that pushed over 50%, we're pretty excited about that.

The other category I'll hit next is network services, which is the network that's SONET-based, traditional services connecting up primarily point to point for our customers. And you can see that's been on a 3-year CAGR of somewhat of a decline. So, there's some replacement going on between that category and Ethernet services, the data and Internet category. Customers renew, they upgrade, they expand their capacity needs, they need more capacity, flexibility, and the enhanced services that we offer. It's not unusual for them to, then, transition to the data and Internet category. While there's still a great need for SONET services and, I would expect, for quite some time to come, within network services.

Now voice services, you can see that's been about a 2%. Everybody has voice services, and we send -- with most of the services we sell, we tend to be a share taker, given our -- on a relative basis, our low market share. And voice is no different. We tend to lead with data and Internet services, get that component from the customer, especially for the medium to larger customers. The larger the customer, the chances are we'll get a piece of their business to start, and then we'll pull in the rest of their services. And voice is one of those that we'll follow on later with.

So, when we look at the trend lines there, this really tells the story of both our historical results, obviously, but also our future vision. Our investing in differentiation is heavily weighted toward the data and Internet line, while we're also investing in voice services with certain features and functionality to further enhance that product offering, as well.

Now this cut is by the customer type. So, enterprise customers, business customers, which is our primary focus, so we do quite well, and we're a great vendor to the carrier customers, as well.

Fact of the matter is, no carrier, not even the really big cap guys go everywhere. And we all have to buy from each other to reach the last location, enhanced location, for our customers.

While in our case, we focus in those dots that Mike pointed out, but we can really reach any place in the country and, actually, internationally, as well. As long as the bulk of the services and revenues are within the dots on the map, we can go anywhere in the country or around the world virtually for the nth location with another carrier to put together the complete package for our customers. And other carriers are no different when they also buy from us.





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But enterprise really is the growth engine. That's where we differentiate. That's what makes our revenue stream so diverse, because we have so many customers buying so many different levels of service from us, and it's been, obviously, very consistent.

So, while-- again, while those lines-- both of these lines look very almost straight, obviously we have fluctuations from quarter to quarter.

Another facet of our business is connectivity to the buildings. The left chart there, as Mike pointed out, we serve almost 17,000 buildings connected with our fiber. And that's really where we can really differentiate with both the size, the capacity we deliver, but also the features and functionality to the customer. We control, more directly, the service quality to our customers.

And -- but going into those buildings it costs capital dollars to go in there. So, it's a very disciplined approach when we connect up to those buildings. So, while we -- from a competitive standpoint, we have the most buildings connected with fiber, it's a very disciplined, success-based model.

First, we sign the customer contract given that business location, and then we pull the fiber. And it's a very strict criteria. All of our -- internal rate of return is common nomenclature throughout our Company, all the way down to the sales rep.

So, when they go into a customer location, they -- we look at what the incremental cost is to build into those locations for the customer, and then we balance that against what the services and the revenue we're generating from that sale, and as long as it hits a 30% internal rate of return over the life of that customer contract, the sales rep has the go-ahead to commit to that deal and provide that quote.

There are some dollar thresholds. When they get up to bigger dollars, they have to come back centrally, but generally we're going to approve of those, quite honestly, as long as the customer qualifies, credit-wise.

But it's -- when you look at the incremental capital, 30% might seem like a high threshold and, quite honestly, we average higher than that, but that's just an incremental. There's a lot of shared infrastructure that we also have to get a return on, and that's why we set the bogey higher when we look at incremental capital spend.

And so you can see that it -- that that plays out well in our overall financials and we balance it against the other capital investments we make from central office augmentation to expanding our IP backbone, expanding our network reach, and that the ROIC continues to expand up a nice trend line. So, you can see the pretax ROIC pushing up toward that 12% line and just a very, again, consistent -- and that's the slower one to move, obviously, when you look at an ROIC -- but it's, obviously, going in the right direction.

And when you think about the fact that we're just pushing \$1.5 billion in revenue and we have a nationwide presence, when you think back to that map, for us to be pushing, as we continue to grow the business, very much a growth and investment model for us, we tend to spend about 23% to 25% of our CapEx -- of our revenue toward CapEx for building entry, for network expansion, for product investment, for capability investment.

But for us to generate the EBITDA margin that we have, when we're spread relatively thin across the country really speaks to the efficiency of the -- kind of that story of one that Mike talked about, one network, one set of systems, one approach, one experience, nationwide, the efficiency of our model.

So, I'm going to dig a little bit more down. There's a lot of numbers on this page, but I wanted to share a little bit more about our -- kind of macro model, when you think about it.

So, let me set this up. So, what we did, we're in 75 markets across the country. And so, what we do, is to get a sense of how they perform differently, a mature versus a less-mature market, in 2007 we ranked their -- ranked those markets by their local EBITDA margin, so no corporate overhead and that sort of thing, just what they're generating at the local level in 2007 and held it constant from that point in time. So, we just put them into arbitrary three buckets to trend them.

So, the only differentiation from an economic standpoint is what their EBITDA margin was. So, there's big markets in the top category, big in the bottom, small in the top, small in the bottom, et cetera.



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And so, what you can see there in 2011, let's do it on an annual basis, that top category generated a local EBITDA margin of about 59% and the bottom category around 32%. The biggest difference between the top and the bottom categories is just how long we've been there, how big the network reach is, reaching more customers, how many buildings are connected, but always driven by selling.

So, it's an annuity recurring revenue business. So, this is kind of the definition of scale. So, the revenue over the cost, and the longer we're there, we build out more reach, more buildings, more customers, more recurring revenue, and it builds up.

The bottom category, we just haven't been there as long. And the bottom category is weighted heavily towards the markets we acquired at the end of 2006 in the Xspedius acquisition -- good core networks, not a lot of buildings, not a ton of revenue. And so as we deploy our model -- and it takes time. As we deploy the model, we get more density in the market, grow the annuity up, and expand the margins.

And you'll see in a minute, when I dig into a couple markets, you know, it also goes into the overall cash flow and returns on the cash flow.

So, and we've proven that -- we've proven this model works. Some markets go a little faster than others. Sometimes there's different economics in the market. Sometimes it's just, quite honestly, it's the people we put in there. So, if you get wrong the first time, it takes several years to get it -- to turn it around and get it right. But we've seen a nice progression in all of our markets.

I guess one thing before I turn the page. When I talk I think investors sometimes they think, well, what happens when that bottom category gets to the top category? The math can get crazy if you take it to the wrong extreme, from an EBITDA and cash flow standpoint, because, obviously, this is a highly competitive environment, so we can't go to infinity. We're already pushing EBITDA margins that rival the -- that, quite frankly, exceed the big guys, so we're in a good place with our overall EBITDA margin. But as that third category gradually moves up, like it's been doing, toward the middle, some progression on the middle category, and then just generating continued growth and cash flow on the top category, we think that's very complementary to long-term margin expansion.

So, I'm going to dig into just a few markets here, just so you can get a little more flavor. So, I picked one in the top category, which is Austin, who's in the top bucket, and then Denver and Vegas were in the bottom bucket. So, that's one from the top and two from the bottom.

Austin you can see we've compared 2008 to 2011 in these slides, but you can see Austin generating that 62% EBITDA margin, and you look at their CapEx to revenue is about 12%.

As a company, we've ranged in the -- in the, like I said, the low 20% of our revenue to our CapEx to revenue, but in Austin, if you go further down, the network goes everywhere in Austin. We have a lot of buildings connected up with our fiber, which means the chances are the next sale in Austin we already have lit, or are really close to that building, so it's not capital intensive to go into that building. And so it's very -- very complementary when you look at cash flow margins and returns.

But Denver and Vegas are good stories, but they're still on growth markets that we don't have a lot of density in. Denver was a -- when the last family of what we call greenfield builds that we just built a new market from scratch that we did in 2001, and we all -- well, maybe not all, but most probably remember the telecom implosion during that same timeframe, so we built it and then we put it on ice, because we were pulling back as we saw that all play out.

And then we started reinvesting again and now it's progressing quite nicely. And you can see the -- excuse me, the metrics expand. But we don't reach too many places, the network isn't as big.

Vegas was part of that acquisition in 2006, good core networks, not our model. It takes a while to deploy our model, get everything working, building momentum. But they're starting to see some nice progress there, as well.

Now one thing we do, to go the other route, which isn't our plan, but we could go out there and go and build 800 route-miles of fiber in all of these markets. We wouldn't have the capital burden in the future, but when you look at the metrics, we don't think that's the right way to go. We think





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the incremental build, the expansion, that continue to reach them, going into the high-growth areas of the market on a very methodical basis is and has been the right way to go.

So, in summary, some of these metrics we talked about before, but it's really one of consistency. Consistent investment for differentiation. I mean, that's really key. Delivering a quality of service to enterprise customers that allows us to really get into more deals and close more deals and continue to generate the nice, strong, balanced growth that we've been able to deliver today.

And with that, I think we're going to go over to the questions.

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## QUESTIONS AND ANSWERS

**John Hodulik - UBS - Analyst**

Okay. Thanks, guys. We have some time for some questions. I'll start it off.

First, if you could -- this one -- maybe this one is for -- either for Mike or for Mark, just characterize the level of competitive intensity you're seeing in the market. Most recently, AT&T announced that they're going to extend fiber to a bunch more buildings in this space. I mean, do you compete predominantly with the big guys as you mentioned, as you spoke about, and do you expect any sort of increase in that from the AT&T build?

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**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

Yes, so we do compete head to head with the incumbents every day. I mean, you think about our capabilities, what we offer our customers, the ability to do those types of services over our own fiber infrastructure, and that's who we compete with.

So, we focus on the medium and large enterprise, and what we've found is that the incumbents are being challenged on a number of fronts. At the high end, the Fortune 1000 sorts of customers, they compete pretty fiercely for that business. It tends to be more global in nature. They have needs that extend beyond the borders. So, we are point solutions for those sorts of customers. We serve the Fortune 1000, about 40% of the Fortune 1000, in some form or fashion because of our capabilities for diversity and redundancy.

And then it's the -- you think about the other end of the spectrum, the small business customers, there's intense competition there for the incumbents in the cable companies, and other competitive providers. So, we sort of carved out that middle market, that medium and large enterprise space, where we still don't see the tremendous competition from the incumbents directly, because they're focused on the other end of the spectrum.

That said, the competition -- nobody wants to lose in the market. I don't know that it really has changed that much over the years, but we focus hard on meeting the needs of those customers that are unserved or unmet by other providers and deliver them a pretty robust set of capabilities.

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**John Hodulik - UBS - Analyst**

Got you, so you see the large guys but you also see some competition from some of the smaller guys, like a Level 3 type or sort of CLECs and that type of customer or competitor or CenturyLink?

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**Mike Rouleau - tw telecom inc. - SVP, Business Development and Strategy**

Yes, so that -- just by the nature of where we do business, we see all three of the incumbent telephone companies, if you will, and then it depends on what the solution is that the customer is looking for where we'll see others. If it's more backbone-related or long-haul in nature, again, I mentioned our focus is really on serving the needs of our customers in the markets that we do business, right, the footprint locally where we can leverage that fiber infrastructure Mark talked about.

